



My Expenses Belong in More Than One Bucket



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Can a CEO or Executive Director's salary and associated expenses be allocated to more than one category of expense on the Statement of Functional Expense? The short answer is, yes. Both the financial accounting rules and the Form 990 instructions require charitable organizations to report expenses by functional classification as well as natural classification. Examples of natural expense classifications often falling into more than one functional expense category are rent, salaries and office supplies. The functional expense categories are program, management and general and fundraising. Although direct allocation is preferred when reasonable, many expenses require allocation to at least two of the three functional expense categories.

The functional expense classification is designed so the reader of the financial statements and Form 990 has more transparency into the organization. Generally accepted accounting principles and the instructions to the Form 990 require charitable nonprofit organizations to allocate total expense into functional expense categories. Organizations are encouraged to disclose functional expense categories in the Statement of Activities, but may also disclose the information in the financial statement footnotes. Voluntary health and welfare organizations, however, are required to utilize a matrix format similar to the Form 990, Part IX, Statement of Functional Expenses, detailing expenses by natural classification and functional expense category.

Donors, the IRS, as well as charity watchdog groups, such as Charity Navigator, highly favor organizations allocating resources to programs. Although everyone agrees the supporting categories are important, organizations generally are encouraged to minimize management and general and fundraising expenses.

Allocation of expenses to functional expense categories should reflect reality while not over burdening the organization. For example, office supplies are a shared cost allocated between program, administrative and fundraising categories, but even the accountants would not suggest counting paperclips. A reasonable basis consistently applied is sufficient. However, there does need to be some basis for the allocation. Time, and how employees of the organization spend it, is often the great "basis maker". Although no one enjoys time keeping, it is one of the best ways to objectively and verifiably allocate shared expenses. When people allocate time to the three functional expense categories, ratios can be established to allocate other shared expenses. Another basis for allocation is square footage of facilities. However, when a single space is used for multiple purposes, we are back to allocating facilities on a basis of time.

General descriptions of the three functional expense categories are:

- 1) Program: Expenses incurred in activities which fulfill the organization's mission or exempt purpose. In the example of a school, grants, scholarships and teacher salaries are program expenses.
- 2) Management and General: Expenses incurred in activities which support the mission or exempt purpose of the organization. In the example of a school, office secretary salary, accounting services and endowment management fees would all likely be a management and general expense.
- 3) Fundraising: Expenses incurred inducing donors to make contributions to the organization. In the case of a school, the development department salaries, printing and mailing of the annual appeal letter are fundraising expenses.

What about the principal? The principal is a shared cost. The principal could keep time records supporting the allocation of their time to the three functional expense categories. Everyone knows a principal has student obligations, many general and management responsibilities, and in a private school, fundraising duties as well. The better the time records, the easier it is to substantiate the allocation to the financial statement auditors or the IRS on examination. The method for allocating shared costs can be established using a baseline and then making allocations based upon the baseline standard. For example, if over a typical 3-month period the principal spends 20 percent of his/her time on program, 70 percent on management and general and 10 percent on fundraising, these percentages can be used as the base of allocating wages, benefits, cell phone usage and other shared costs, where this time baseline makes sense. The allocation percentages should be revisited periodically to determine if they are still valid.

As organizations are asked to do more with less, sharing resources throughout the organization is necessary. Establishing reasonable baselines for allocating shared costs should reflect the reality of the organization. Reasonable allocation methods which are consistently applied are acceptable and expected in all charitable nonprofit organizations.

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We would be happy to assist you with any of your questions. Please call us at 941-365-4617 or email Rob Lane at rlane@kbgrp.com or Patricia Entsminger at pentsminger@kbgrp.com.